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In The Supreme Court of the United States

THOMAS FRY,

Petitioner,

v.

EXELON CORPORATION CASH BALANCE PENSION PLAN,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITIONER'S REPLY BRIEF

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INTRODUCTION

Judge Easterbrook's opinion for the Seventh Circuit: (a) misinterprets a core provision of ERISA, (b) invalidates a Treasury regulation's reasonable interpretation of that statutory provision, and (c) draws the Seventh Circuit into conflict with the Second Circuit. The Exelon Corporation Cash Balance Pension Plan ("the Plan") Opposition Brief attempts to conceal these realities. Petitioner files this Reply to address the new issues raised by the Plan.

The Exelon Corporation adopted its definition of "normal retirement age" in an effort to exempt itself from Treasury Department regulations.[1] Despite prior rulings that drafting around ERISA mandates was prohibited,[2] Judge Easterbrook blessed Exelon's stratagem. App. at 4a. In so doing, he ignored clear congressional intent, Treasury regulations and this Court's holdings on deference to agency interpretations of law. Petitioner respectfully requests the Court seek Treasury's view on this issue.

Contrary to the Plan's assertions, this case raises compelling questions of ongoing national importance regarding the interpretation of a core provision of ERISA ("normal retirement age") and the deference

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[1] *See Fry v. Exelon Corporation Cash Balance Pension Plan*, No. 09-cv-53, Doc. No. 30 at 15 (N.D. Ill. Nov. 12, 2009), where the Plan argues its definition of "normal retirement age" exempts it from ERISA's anti-backloading provisions.

[2] *See Esden v. Bank of Boston*, 229 F.3d 154, 173 (CA2 2000) ("The Plan cannot contract around the statute."); *West v. AK Steel Corp. Ret. Accum. Pension Plan*, 484 F.3d 395, 408 (CA6 2007) (same).

owed to executive agencies charged with interpreting the law, which directly impact thousands of Americans. Judge Easterbrook's opinion strikes a blow to one of ERISA's core purposes (to provide for *retirement* benefits - *see* Cert. Pet. at 11-12), and raises profound questions regarding the rule of law and separation of powers. Only this Court can settle the conflict the Seventh Circuit's ruling creates between itself, Treasury and other Circuits. If the ruling below is allowed to stand, other employers will adopt similar definitions of "normal retirement age" to avoid ERISA's safeguards. This case deserves the Court's review.

REASONS FOR GRANTING THE PETITION

A. The Plan's Argument that this Case Raises No Questions of Ongoing Significance Misrepresents the Law and Distorts the Seventh Circuit's Decision.

The Plan claims that "the petition presents an issue of no ongoing significance" because: (1) the Pension Protection Act of 2006 ("PPA") "abolished the whipsaw calculation altogether" and (2) the Treasury Department's 2007 regulation regarding the definition of 'normal retirement age' will govern future disputes. Opp. Brief at 8, 9-10. Both claims are false.

1. Even under the PPA, plans must perform a "whipsaw calculation" if the rate at which interest is credited under the plan is greater than a market rate of return.

Contrary to the Plan's (and the Seventh Circuit's) assertion that the so-called "whipsaw calculation" is dead (Opp. Brief at 9-10; App. at 3a), ERISA and Treasury still require plans to perform a whipsaw calculation if the plan's interest crediting rate exceeds a market rate of return. *See* 26 U.S.C. § 411(b)(5)(B)(i)(I) ("An applicable defined benefit plan shall be treated as failing to meet the requirements of paragraph (1)(H) unless the terms of the plan provide that any interest credit (or an equivalent amount) for any plan year shall be at a rate which is not greater than a market rate of return."); IRS Notice 2007-6 (same); *The Boeing Company*, 2008 WL 485464, 5 (S.E.C. No-Action Letter) ("cash balance plans can be tested for compliance . . . without the need to take into account projections to normal retirement age, as long as the rate at which interest is credited to the participants' accounts is not greater than a market rate of return.").

Because many plans, including the Plan, provide interest credits that exceed a market rate of return, ERISA continues to require a whipsaw calculation when "cash balance" plans make lump sum distributions before normal retirement age. Thus, the Plan's argument that this petition should be denied because "whipsaw" is dead misrepresents the law.

2. *Treasury's 2007 regulation will not govern future disputes if Judge Easterbrook's ruling is allowed to stand.*

The Plan's claim that Treasury's 2007 regulation settles matters going forward is also false. The 2007 regulation will govern future disputes only if it validly interprets ERISA. But because Judge Easterbrook has held that ERISA clearly permits what the regulation specifically prohibits, the 2007 regulation will govern future disputes *only if Judge Easterbrook's ruling is overturned*.

The Plan distorts the question presented to the Seventh Circuit. According to the Plan, the only question below was whether the Plan's definition of normal retirement age was *consistent with* ERISA's text. Opp. at 11. The Plan is incorrect. The Court will look in vain for the words 'consistent', 'inconsistent' or their cognates in Judge Easterbrook's opinion. The issue of whether the Plan was consistent with ERISA's text was not even discussed, much less was it the "only issue" before the court.

Judge Easterbrook framed the issue in terms of the discretion ERISA gives employers. App. at 5a ("How much discretion employers enjoy when selecting a 'normal retirement age' depends on the language of ERISA"). Despite ERISA's silence on employer discretion, Judge Easterbrook held that ERISA unambiguously provides employers essentially unlimited discretion. *Id.* at 7a ("Under [ERISA] an age is the 'normal retirement age' because the plan's text makes it so."). He concludes by underscoring that, under his interpretation, ERISA *permits* precisely what the 2007 regulation *prohibits*: "[W]e have

analyzed the statutory language directly. . . . [T]he statutory language allows employers to specify a 'normal retirement age' that differs from typical retirement patterns." *Id.* at 8a. The court's holding directly contradicts Treasury's 2007 regulation, which requires that "the normal retirement age under a plan be an age that is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed." App. at 52a.

What the Seventh Circuit has held ERISA unambiguously *permits*, the Treasury Department cannot *prohibit*. *See FCC v. American Broadcasting Co.*, 347 U.S. 284, 296 (1954) (agency cannot make illegal by regulation what is legal under the statute); *Manhattan General Equipment Co. v. Commissioner of Internal Revenue*, 297 U.S. 129, 134-135 (1936) ("A regulation which . . . operates to create a rule out of harmony with the statute, is a mere nullity.").

The Plan's claim that this case is not worthy of this Court's attention because "whipsaw" is dead and the 2007 regulation will render Judge Easterbrook's bizarre rulings harmless on a going-forward basis are false and contrary to law. If allowed to stand, the ruling below not only creates a conflict with the Second Circuit, invalidates reasonable Treasury regulations and strikes a blow to ERISA's core purposes, it directly threatens the pensions of thousands of Americans participating in plans, which like Exelon's, impermissibly define "normal retirement age" to avoid ERISA's and the IRC's requirements.

B. The 2007 Regulation was *Not* a "Change in Agency Policy" on the Permissibility of Defining "Normal Retirement Age" Without Specifying an Age.

Judge Easterbrook held that ERISA unambiguously permits what the 2007 regulation prohibits, thereby invalidating the regulation. The Plan pretends this has not happened and focuses attention elsewhere. The Plan argues the Seventh Circuit properly refused to give the 2007 regulation "retroactive" application because it purportedly amounted to a "change in agency policy." Opp. at 12-15. The Plan's argument is a red herring. For the alleged "change in agency policy" to excuse a court from giving *Chevron* deference to Treasury's reasonable interpretation of the statute, the change must have impaired the Plan's legal rights or reasonable expectations. *See Landgraf v. USI Film Products,* 511 U.S. 244, 265-266, 269-270, 280 (1994). Here, however, neither the lower courts nor the Plan attempt to show that Treasury *permitted* plans to define "normal retirement age" as a "five-years vesting service" without specifying an age *before the 2007 regulation*. Treasury *never* permitted plans to define "normal retirement age" without specifying a chronological age. Treasury has always required that normal retirement age be specified as *an age*. *See* Cert. Pet. at 4-6. Consequently, the 2007 regulation did not impair Exelon's rights or reasonable expectations.

1. Revenue Ruling 78-120 did not approve defining "normal retirement age" without specifying an age.

The Seventh Circuit (without analysis of prior agency rulings and regulations) found that, prior to the 2007 regulation, Treasury gave employers *carte blanche* to define "normal retirement age" without specifying an age. App. at 4a, 7a. The only alleged support for that claim is Rev. Rul. 78-120.[3] But Rev. Rul. 78-120 did not permit the Plan's "five-years vesting service" definition and nowhere suggests that plans may define "normal retirement age" without specifying an age. In fact, Rev. Rul. 78-120 was written to provide guidance only for plans that *do* specify an *age* as "normal retirement age." Rev. Rul. 78-120 (describing the plan-type addressed as "provid[ing] that, *upon attaining a certain specified age* (less than 65)") (emphasis added). Treasury concluded that *such a plan* "will not fail to qualify under section 401(a) of the Code merely because it provides for a normal retirement age of less than 65." *Id.* In the process of explaining its position, Treasury assumes every qualifying plan specifies an age as normal retirement age. *Id.* ("a plan may specify any age that is less than 65 as the normal retirement age. However, if the normal retirement age specified in a plan is less than 55 . . ..").

No fair reading of Rev. Rul. 78-120 could find that Treasury gave the green light to define "normal

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[3] The only authority the Seventh Circuit offers is the commentary in the 2007 Regulation itself, which refers to Rev. Rul. 78-120. *Compare* App. at 7a and 49a.

retirement age" as "five-years vesting service" without specifying an age. Consequently, the 2007 regulation was not a "change in policy" that transformed the Plan's definition from "permissible" to "invalid," and did not otherwise interfere with the Plan's rights or legitimate expectations.

2. *Treasury, consistent with Congressional intent, has always required "normal retirement age" to be defined by reference to a specified age.*

Congress made clear its intention that "normal retirement age" be "defined by regulations" and should be an "age." *See* S. Rep. 93-383, 1974 U.S.C.C.A.N. 4889, 4936 (Aug. 21, 1973) ("The term 'normal retirement age' is to be defined by regulations. It is expected that a minimum and maximum age will be taken (perhaps 55 and 65)"). For decades prior to Rev. Rul. 78-120, Treasury consistently required normal retirement age to be defined as a *specified age*. *See, e.g.*, Rev. Rul. 56-693, 1956-2 C.B. 282; 21 Fed. Reg. 7269, 7279 (Sep 25, 1956) ("Normal retirement age is not lower than age 65 for men and not lower than age 60 for women."); Cert. Pet. at 4-6 (discussing regulatory history).

There is no legal or factual basis for the claim that prior to the 2007 regulation the Plan's definition was valid under Treasury regulations. The Plan, therefore, avoids the subject. Instead, the Plan claims that the 2007 regulation amounted to a "change of policy." Opp. at 4-5, 13-15. This is simply a red herring. The alleged "change in policy" did not transform the Plan's definition from "permissible" to "invalid." It did not interfere with the Plan's existing rights or reasonable

expectations. Rather, the 2007 regulation simply announced *another reason* the Plan's definition is invalid. The Plan's definition of normal retirement age was invalid both before and after the 2007 regulation.

C. The Plan's Attempt to Characterize Deferring to Treasury's Consistent and Reasonable Interpretation of ERISA and the IRC as an "Impermissible Retroactive Application of Law" is Baseless.

Courts are appropriately hesitant to apply a "change in law" retroactively to deprive people of legal rights on which they relied. *See Greene v. U.S.*, 376 U.S. 149, 160 (1964) ("a retrospective operation will not be given to a statute which interferes with antecedent rights"). But that is not the situation here. Here the Plan *never* had a right or a reasonable expectation that it could define "normal retirement age" as "five-years vesting service" without specifying an age as normal retirement age. Nevertheless, the Seventh Circuit accorded the Plan the same protection as those whose rights have actually been taken away. App. at 7a. This Court should make clear that it rejects the Seventh Circuit's dramatic expansion of the rule against "retroactive" application of changes in law.

Similarly misplaced is the Plan's argument that the courts below were not required to give *Chevron* deference to Treasury's interpretation of the law because the "effective date" of the 2007 regulation was after petitioner received his lump sum distribution. Opp. at 13-15. This Court has squarely rejected that argument, referring to the Plan's and Seventh Circuit's position as "absurd." *See Smiley v. Citibank (South*

Dakota), N.A., 517 U.S. 735, 740-742 (1996); *see also* Cert. Pet. at 22-26. The Plan's position bears no scrutiny.

D. The Seventh Circuit's Ruling Conflicts with the Second Circuit's Longstanding Recognition that Definitions of "Normal Retirement Age" Solely by Reference to a Period of Vesting Service Formula are Invalid.

The Plan claims that because this case does not address the precise question presented to the Second Circuit in *Duchow v. New York State Teamsters Conf. Pension and Ret. Fund*, 691 F.2d 74 (CA2 1982), no conflict exists. Opp. at 16-17. But a "conflict" exists when the positions adopted by the circuits are mutually inconsistent. The Plan here makes no effort to explain how the ruling in *Duchow* -- that ERISA prohibits a definition of "normal retirement age" based solely on "years of vesting service" -- and the decision below – that such a definition is expressly permitted by ERISA -- can both be correct. They cannot. *See* Cert. Pet. at 29-33; *see also Hlinka v. Bethlehem Steel Corp.*, 863 F.2d 279, 281 n.3 (CA3 1988) ("absent an express provision as to age in a pension plan the normal retirement age is 65 pursuant to ERISA.") (superseded on other grounds).

Because the Seventh Circuit's ruling that a vesting service formula definition of "normal retirement age" is permissible contradicts the Second Circuit's ruling in *Duchow* (as well as Treasury's long-standing requirement that an age be specified as normal retirement age), there is a genuine conflict between the circuits. *See also Hlinka*, 863 F.2d at 281 n.3.

CONCLUSION

The errors in the Judge Easterbrook's opinion for the Seventh Circuit raise vital questions of ongoing national importance regarding the interpretation of a core provision of ERISA. Judge Easterbrook's holding that ERISA directly addressed the question of Plan discretion in defining "normal retirement age" and gives plans unfettered discretion to define that expression strikes a blow to one of ERISA's core purposes (to provide for *retirement* benefits) and raises profound questions regarding the rule of law and separation of powers.

The Court should grant the petition for a writ of certiorari or summarily reverse and remand the Seventh Circuit's ruling, with instructions to follow this Court's rulings in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-843 (1984) ("if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute") and *Smiley*, 517 U.S. at 740-741, 744 n.4 ("it would be absurd to ignore the agency's current authoritative pronouncement of what the statute means.").

Respectfully Submitted,

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